

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA****DIVISION OF WATER AND AUDITS  
Water and Sewer Advisory Branch****RESOLUTION NO. W-4940  
February 13, 2013****R E S O L U T I O N**

**(RES. W-4940), CALIFORNIA AMERICAN WATER COMPANY (CAL-AM). ORDER AFFIRMING THE DIVISION OF WATER AND AUDIT'S (DWA'S) REJECTION OF ADVICE LETTER (AL) 923; ORDER APPROVING, IN PART, AL 932 FOR THE TRANSFER OF \$517,212 TO RATE BASE PURSUANT TO DECISION (D.) 10-12-016 AND FINDING THAT \$199,408 OF CLAIMS IN AL 932 SHOULD NOT BE AUTHORIZED IN RATES AT THIS TIME.**

**By AL No. 923 filed November 15, 2011 and AL No. 932 filed on February 27, 2012.**

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**SUMMARY**

This Resolution affirms DWA's rejection of Cal-Am's Advice Letter (AL) 923 for insufficient supporting information.<sup>1</sup> This Resolution approves, in part, Cal-Am's request to transfer to rate base \$517,212. This Resolution does not authorize in rates \$199,408 for unsupported labor overhead, improperly claimed project outreach expenses, legal expenses, unauthorized project claims, claims without invoices and pro-rated Allowance for Funds Used During Construction (AFUDC) expenses. Cal-Am may file for claims rejected herein subject to future direction as provided by the California Public Utilities Commission (CPUC) in Decision (D.) 12-07-008.

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<sup>1</sup> AL 923 was filed as a Tier 2 filing per D.10-12-016. Tier 2 filings are subject to review by the operating Division. AL 923 was rejected by DWA through a letter of disposition. Cal-Am requested the Commission to review DWA's disposition of AL 923. Cal-Am also filed AL 932 as a Tier 2 filing replacing AL 923. Since AL 932 raises many of the same issues as addressed in the disposition rejecting AL 923, the review of Cal Am's appeal of AL 923 and the disposition of AL 932 are being addressed together through this Resolution.

## **I. CAL-AM AL NO. 923**

### **1. BACKGROUND**

Cal-Am filed AL No. 923 on November 15, 2011. In its filing, Cal-Am requested authority to implement a rate change authorized by the CPUC in D.10-12-016 for Cal-Am's Monterey District. The purpose of the rate change is to reflect in rate base plant additions for Cal-Am only facilities associated with the Regional Desalination Project in Monterey County.<sup>2</sup> The costs incurred are to construct, operate, and maintain pipeline, conveyance, and pumping facilities necessary to deliver the Monterey County Regional Desalination Project water to its customers consistent with the Settlement Agreement that was adopted in D.10-12-016. Under the rate increase proposed in AL 923, Cal-Am would record in rate base an additional \$785,460, including \$32,361 of AFUDC in rate base.

The Division of Ratepayer Advocates (DRA) requested additional time to review backup documentation supporting Cal-Am's expenses as enumerated in AL 923. On December 13, 2011, Division of Water and Audits (DWA) suspended AL 923 to allow DRA to complete its review of this filing.

### **2. NOTICE**

Cal-Am served AL No. 923, in accordance with General Order 96-B (GO 96-B), to adjacent utilities, persons on its GO 96-B Monterey District Service List, and parties to D.10-12-016. GO 96-B requires customer notification in this instance. Although Cal-Am did not provide customer notice of AL 923, Cal-Am replaced this AL with AL 932 and provided the necessary customer notice.<sup>3</sup>

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<sup>2</sup> The Regional Desalination Project involved a partnership between Cal-Am and some public agencies to develop a water desalination facility and aquifer storage and recovery system. Under this partnership, Cal-Am would construct, own, operate, and maintain certain facilities, i.e., the Cal-Am only facilities, and the public agencies would construct, own, operate and maintain other facilities. As discussed in D.10-12-016, the Cal-Am only facilities were the: 1) Monterey Pipeline, including the Valley Greens pump station; 2) Transfer Pipeline; 3) Seaside Pipeline; 4) Terminal Reservoir; and 5) Aquifer Storage and Recovery Facilities. Subsequently, Cal-Am filed an application to pursue a different project. (Cal-Am filed A.12-04-019 to pursue the Monterey Peninsula Water Supply Project instead of the Regional Desalination Project.) In D. 12-07-008, the Commission allowed Cal-Am to proceed with this new project. However, in Ordering Paragraph 2 of this decision, the Commission directed DWA to continue processing all currently unprocessed ALs dealing with rate base offsets for Cal-Am only facilities discussed in D. 10-12-016. As explained further below, per D.10-12-016, Cal-Am may seek to recover prudently expended costs for the five Cal-Am projects.

<sup>3</sup> Accordingly, Cal-Am's failure to provide notice with respect to AL 923 does not harm ratepayers in light of DWA's rejection of AL 923 and Cal-Am's provision of notice with respect to AL 932, which replaced AL 923,

### **3. DRA's PROTEST**

On December 21, 2011, DRA timely protested Cal-Am's AL 923. In its protest, DRA noted that Cal-Am's submittal lacked adequate documentation for the claimed amounts; and Cal-Am should not be permitted to add any of the amounts requested to rate base until it provides proper supporting documentation. Specifically, Cal-Am:

- (i) failed to provide adequate support for \$342,177 of capital additions;
- (ii) did not identify any authorized projects for \$753,099 of rate base it is seeking to capitalize;
- (iii) used an incorrect interest rate for AFUDC; and
- (iv) erred by increasing the block 1 rates for the Bishop area.
- (v) Cal-Am responded to DRA's protest on January 6, 2012. Cal-Am stated that DRA's protest did not set forth reasonable or sufficient grounds for denying or delaying its rate recovery as authorized by D.10-12-016. Specifically:

#### *i. Support for \$342,177 in claimed capital additions*

Cal-Am claims support is provided for the entire \$753,099 capital costs. Of this amount, \$410,921 is supported by invoices. The remaining \$342,177 in claimed capital costs included \$177,668 for Contracted Services, \$3,575 for Professional Services, and \$160,934 for labor overhead. Invoices were furnished for amounts claimed for Contract Services and Professional Services. No invoices exist for Labor Overheads.

Cal-Am indicates that it used the same methodology to calculate the Labor Overhead for the Regional Desalination Project (RDP) and the Coastal Water Project (CWP) pre-construction costs in proceeding Application 11-06-030. DRA accepted that methodology as evidenced by an audit report that it submitted for Cal-Am's Pre-Construction recovery costs for the CWP. Since the same methodology was used for the two projects, Cal-Am claims the labor and overheads are appropriate and should be accepted for the RDP.

#### *ii. Cross-referencing Projects for the \$753,099 added to ratebase*

Cal-Am provided the same level of documentation that it provided in AL 895, which was approved by DWA on June 11, 2011. No cross-referencing to approved projects was required for AL 895. Therefore, Cal-Am claims that approval of AL 923 should not be contingent on receiving such information. In any case, Cal-Am claims it has provided project specific costs for AL 923.

Cal-Am also reported that it discovered that general overhead costs were overestimated in its original filing by approximately \$36,479. Cal-Am will make the appropriate adjustments in its tariffs.

*iii. AFUDC rates*

Cal-Am disagrees with DRA's contention that it should use 4% as the interest rate for AFUDC. While D.10-12-016 sets the initial AFUDC rate at 4%, it also provides for a "true-up to reflect actual carrying costs." Cal-Am states that 8.04%, its authorized weighted average cost of capital, is lower than its actual carrying costs and is the best financing available to it for this project. Accordingly, Cal-Am claims that using 8.04% for the AFUDC rate is proper and authorized by D.10-12-016.

*iv. Bishop Tariff Sheet Calculation*

Section 9.6 of the Settlement Agreement, adopted in D.10-12-016, does not permit Block 1 rates to be increased as is currently shown on Cal-Am's tariff sheets for Bishop. Cal-Am submitted a slip sheet to DWA for AL 923 and AL 926 (for Monterey Interim Rates) to reverse the rate increase for Bishop's Block 1 rates.

**4. DWA's DISPOSITION OF ADVICE LETTER NO. 923**

On February 12, 2012, DWA rejected AL 923 without prejudice. In its letter of disposition, DWA informed Cal-Am that its AL filing was deficient and the utility may re-submit its request to implement a rate change by filing a new AL with the following modifications:

1. Provide backup support for all labor and overhead related expenses.
2. Map each claimed expenditure Cal-Am seeks to capitalize in rate base to specific projects that are authorized in D.10-12-016.
3. Use an AFUDC rate of 4%.

## **II. CAL-AM'S REQUEST FOR REVIEW OF DWA'S LETTER OF DISPOSITION OF ADVICE LETTER NO. 923**

### **1. BACKGROUND**

On February 21, 2012, Cal-Am requested a formal review of DWA's disposition of Cal-Am's AL 923 by the Commission.<sup>4</sup> Cal-Am believes that DWA's rejection of AL 923 is unlawful and erroneous, does not present reasonable grounds for denying its requested rate recovery for its Monterey County District as authorized by the Commission in D.10-12-016, and a resolution of the issues is necessary to prevent rejections of future semi-annual AL filings. Specifically, Cal-Am claims the following:

- i. Cal-Am provided sufficient documentation to explain its calculations and methodology for its labor and overhead expenses;
- ii. Cal-Am's provided supporting documentation to justify that its request is adequate and is consistent with the requirements of D.10-12-016. Requiring cross-referencing of each expenditure and invoice with an authorized project is unsupported.
- iii. Using an initial 4.00% rate is inconsistent with the directives contained in D.10-12-016. The AFUDC rate of 8.04% accurately reflects Cal-Am's carrying costs and is the best available cost of financing the project by Cal-Am.

Cal-Am believes that additional requirements imposed by DWA go beyond the requirements of D.10-12-016 and are preventing it from recovering its reasonably incurred costs in a timely manner.

### **2. DISCUSSION**

#### ***i. Justification for labor and overhead expenses***

Labor expenses related to \$177,668 for Contracted Services and \$3,575 in Professional Services, and \$114,065 without AFUDC for Labor Overhead included in AL 923 lack supporting documentation. Providing Cal-Am witness testimony in A.11-06-030 describing the components included in Overhead is insufficient. Out of \$342,117 in unsupported expenditures, Cal-Am was able to supply supporting documentation for \$46,868 (labor: \$35,256 + labor overhead: \$11,612).

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<sup>4</sup> Letter from Sarah E. Leeper, Vice-President – Legal, Regulatory, California American Water to Rami Kahlon, Director, Division of Water and Audits, Dated February 21, 2012.

D.10-12-016 provided broad policy that expenditures on the Regional Desalination Project must be reasonable and prudently incurred.<sup>5</sup> With respect to the Cal-Am facilities, the Settling Parties proposed, and the Commission adopted, a process for approving prudently incurred project costs. (D.10-12-016, Section 13.2.2 stating “The Settling Parties propose that the Commission authorize Cal-Am to file...advice letter[s]...to include all prudently expended costs related to construction of the Cal-Am facilities into rate base ...”; Ordering Paragraph 1, approving the Settlement Agreement.<sup>6</sup>) Cal-Am did not provide supporting documentation for all labor and overhead expense claims for the RDP. As a result, DWA cannot verify that these claimed costs are appropriate. DWA is justified in requiring Cal-Am to furnish such documentation prior to approving labor and overhead expenses.

*ii. Cross-referencing of claimed capital expenses to authorized projects*

Cal-Am notes that detailed scrutiny of claimed amounts is not required so long as the total does not exceed the cost cap established for Cal-Am only facilities in D.10-12-016. Therefore, requiring additional information to verify Cal-Am’s claims modifies the requirements of D.10-12-016.

Only prudently expended construction costs associated with five projects may be added to rate base through the advice letter process authorized in D.10-12-016. These projects are the: 1) Monterey Pipeline, including the Valley Greens pump station; 2) Transfer Pipeline; 3) Seaside Pipeline; 4) Terminal Reservoir; and 5) Aquifer Storage and Recovery Facilities.<sup>7</sup> Due diligence requires that claimed costs are incurred only for the authorized projects. In addition to ensuring that total costs claimed are below the approved cost caps established for the project, a determination needs to be made that the cost components have been prudently incurred. In order for DWA to make this

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<sup>5</sup> See, e.g., D.10-12-016, at pp. 75-88 [Section 11.2.1 Discussion: Cost Controls and Determination of Reasonable and Prudent Costs].

<sup>6</sup> The Commission approved this matter in D.10-12-016 without making any amendments to the Settlement Agreement.

<sup>7</sup> As enumerated in D.10-12-016, Ordering Paragraph No. 7.

determination, DWA needs to examine the document to determine that the costs have indeed been incurred and to understand and evaluate which cost(s) have been expended for which project in order to assess whether the expenditure of that cost for that particular project was needed and was reasonable. Thus, DWA's request for cross referencing and mapping claimed capital expenses to authorized projects prior to adding those expenses to rate base is appropriate.

*iii. Appropriate AFUDC rate*

D.10-12-016 establishes an initial AFUDC rate at 4% subject to "true-up to reflect actual carrying costs."<sup>8</sup> Cal-Am used internally generated funds and an interest rate of 8.04% to finance the project without investigating outside sources of funding for a better rate. The utility did not adequately demonstrate that this was the best available rate for this project. Cal-Am should use the initial rate of 4% as specified in D.10-12-016.

In summary, DWA's requirement for Cal-Am to furnish supporting documentation for labor and overheads, cross referencing all costs to approved projects, and using a 4% initial interest rate for AFUDC are consistent with the requirements of D.10-12-016.

**III. CAL-AM'S ADVICE LETTER NO. 932 FILING**

**1. BACKGROUND**

On February 27, 2012, Cal-Am filed AL 932 replacing AL 923. Cal-Am did not withdraw its appeal of AL 923 in filing AL 932. Also, Cal-Am did not withdraw its appeal of AL 923 in any other correspondence with the Commission. Accordingly, above we addressed Cal-Am request for review of DWA's disposition of AL 923. AL 932 raises many of the same issues as addressed in the disposition rejecting AL 923. We address those issues below.

In its filing of AL 932, Cal-Am made adjustments for errors noted in AL 923 and modified the AFUDC contribution by using a 4% interest rate. As a result, the requested addition to rate base was adjusted to \$716,621 including \$12,163 for AFUDC.<sup>9</sup> The resulting Revenue Requirement is an increase of \$92,202 or a 0.21% increase in revenues for the Monterey District. Cal-Am requests authorization to increase rates for Cal-Am's Monterey Main, Bishop, Hidden Hills, and Ryan Ranch System customers

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<sup>8</sup> Conclusion of Law No. 57 at page 202.

<sup>9</sup> A review of work papers submitted by Cal-Am indicates that Cal-Am requested claims total \$717,171.80. This is \$551.29 higher than the claimed amount of \$716,620.51. All claim amounts have been modified for this discrepancy.

located in the Monterey District as authorized by D.10-12-016 for the semi-annual Coastal Water Project Advice Letter filing. Cal-Am notes that it modified the AFUDC rate to 4% even though it did not believe that such a rate was reasonable. It was using that interest rate to expedite cost recovery.

## **2. NOTICE AND PROTEST**

Cal-Am provided customer notice of AL 932. Cal-Am served AL 932 on its General Order 96-B Monterey District Service List, adjacent utilities, and parties to D.10-12-016. DRA filed a protest.

## **3. PROTEST BY DRA**

DRA protested AL 932 on March 15, 2012.<sup>10</sup> DRA noted that Cal-Am's request contained imprudently expended costs that are not permitted by D.10-12-016. Only five projects were authorized, and Cal-Am's filing does not support that the requested amounts are for the five authorized projects. Specifically Cal-Am:

- i. Did not show how outreach expenditures were required for the authorized projects.
- ii. Included costs for slant wells, which do not appear to be authorized.
- iii. Has new contracts with invoices that need to be traced to the authorized projects.
- iv. Invoices lacked support that the work performed was for the authorized projects.

DRA argues that Cal-Am's withdrawal of support for the Regional Desalination Project has changed the circumstances under which D.10-12-016 was adopted by the Commission. As a result, DRA believes it is highly likely that the Commission will modify D.10-12-016. DRA recommends that further action on AL 932 should be stayed pending a resolution of these issues by the Commission.

DRA requested additional time to review backup documentation supporting Cal-Am's expenses as enumerated in AL 932. On March 20, 2012, DWA suspended AL 932 to allow DRA to complete its review of AL 932. DRA submitted results of its audit to DWA on June 22, 2012.<sup>11</sup>

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<sup>10</sup> Letter from Danilo Sanchez, Program Manager, DRA to Rami Kahlon, Director of DWA, dated March 15, 2012.

<sup>11</sup> Letter from Danilo Sanchez, Program Manager, Division of Ratepayer Advocates, to Rami Kahlon, Director, Division of Water and Audits, dated March 22, 2012.



#### **4. CAL-AM'S RESPONSE TO DRA'S PROTEST**

Cal-Am responded to DRA's protest on March 26, 2012.<sup>12</sup> In its response, Cal-Am stated that DRA's protest does not set forth reasonable or sufficient grounds for denying or delaying Cal-Am's requested rate recovery. Cal-Am states that: (i) AL 932 satisfies the requirements of D.10-12-016 and (ii) DRA's request to stay AL 932 would require DWA to ignore the requirements of D.10-12-016 and unlawfully modify the effectiveness of D.10-12-016 through the AL process.

Cal-Am believes that DWA should not hold up approval of AL 932 and should reject DRA's requests because they are procedurally improper, are erroneous and would require actions that are inconsistent with D.10-12-016.

##### ***i. Stay of implementation of D.10-12-016***

Cal-Am believes DRA's request to stay the implementation of D.10-12-016 with regard to the authorized rate base offset treatment for Cal-Am only facilities is inappropriate. Cal-Am states that DRA should file a Petition to Modify D.10-12-016 if it wants to modify the recovery process for rate base offsets that the Commission established in D.10-12-016. Cal-Am believes that DWA lacks the authority to stay the implementation of a Commission Decision without an order from the Commission.

##### ***ii. Costs associated with slant wells***

Cal-Am believes DRA mischaracterizes costs for slant wells, which Cal-Am states are authorized for AL recovery. Cal-Am indicates that the Public Agencies, Marina Coast Water District and the Monterey County Water Resource Agency, are exempt from paying the fees but, as the only private entity named on the permit application, Cal-Am was responsible for paying the fees. While the slant well is not directly a part of one of Cal-Am's five authorized projects, it is a required component cost for the overall project. Furthermore, at the time the payment of the fee was made, California Coastal Commission permit was a critical path item for the Regional Desalination Project to move forward.

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<sup>12</sup> Letter from Sarah E. Leeper, Vice-President – Legal, Regulatory, California American Water Company to Rami Kahlon, Director, Division of Water and Audits, dated March 26, 2012.

*iii. Costs that Cal-Am seeks to recover are legitimate and were incurred when the Regional Desalination Project was still moving forward.*

Cal-Am claims that the requested rate recovery is for charges that were incurred at a time when the parties were still moving forward with the RDP. Most of the charges in AL 932 were general and could not be attributed to a specific project. Furthermore, AL 932 reflects changes in calculations that DRA took issue with in its audit of AL 923.

## 5. DISCUSSION

*i. Stay of implementation of D.10-12-016*

A stay in implementation of a Commission Order may only be done through an order of the Commission. If DRA wishes to pursue its request for a stay in implementation of D.10-12-016, it may do so through a petition for modification of D.10-12-16. Such a request has not been made by DRA, and the Commission has not issued a stay for processing AL 932. Therefore, DWA is authorized to process Cal-Am's claims in AL 932 on its merits and reject DRA's request for a stay.

*ii. Costs associated with Slant Wells*

D.10-12-016 requires Cal-Am to place in rate base capital costs that are associated with five specific projects. Any costs that are not directly related to any of these five projects may not be transferred to rate base as part of the rate base offset advice letter process authorized in D.10-12-016. Slant wells are not one of the authorized projects that Cal-Am may add to rate base through the advice letter process per D.10-12-016. Due to this, claims for costs associated with slant wells should be removed from amounts claimed under AL 932.

*iii. Recovery of Cal-Am claimed costs*

Only prudently incurred costs associated with the five projects authorized by D.10-12-016 may be added to rate base. DWA evaluated Cal-Am expenditures for which recovery is sought in AL 932 for prudence.<sup>13</sup>

By AL 932, Cal-Am submitted claims for \$716,621 including AFUDC of \$12,163. Based on a review of supporting documents provided by Cal-Am, DWA recommends that Cal-Am should be allowed to transfer to rate base \$517,212 including \$8,781 in AFUDC. DWA recommends that claims for \$199,408 including AFUDC of \$3,382 should not be authorized for recovery in rates at this time (currently not authorized amount). These amounts are comprised of: (a) unsubstantiated Labor overhead (\$77,586);

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<sup>13</sup> As discussed above, DWA evaluates the documentation provided to determine whether the documentation is adequate, whether the expenditure can be tied to a specific project and whether the expenditure needed to be made and was reasonable.

(b) improperly claimed outreach expenses (\$32,231); (c) improper legal expenses (\$3,576); (d) improperly claimed slant well related costs (\$20,000); (e) invoices lacking detailed description of work done (\$62,633), and (f) prorated AFUDC for amounts not authorized for recovery in rates (\$3,382). See Tables 1 and 2.

<b>Table 1: Disposition of Amounts claimed in Cal-Am AL 932</b>								
<b>Claimed amount</b>			<b>Currently not authorized</b>			<b>Currently authorized amount</b>		
<b>Capital Costs</b>	<b>AFUDC</b>	<b>Total</b>	<b>Capital Costs</b>	<b>AFUDC</b>	<b>Total</b>	<b>Capital Costs</b>	<b>AFUDC</b>	<b>Total</b>
<b>a</b>	<b>b</b>	<b>c=a+b</b>	<b>d</b>	<b>e</b>	<b>f=d+e</b>	<b>g=a-d</b>	<b>h=b-e</b>	<b>i=g+h</b>
\$ 704,458	\$ 12,163	\$ 716,621	\$ 196,026	\$ 3,382	\$ 199,408	\$ 508,431	\$ 8,781	\$ 517,212

<b>Table 2: Summary of currently not authorized claims</b>			
	<b>Item</b>	<b>Currently not authorized</b>	<b>Description</b>
	<b>a</b>	<b>b</b>	
1	Labor Overhead	\$ 77,586	No backup computations maintained by Cal-Am.
2	Outreach Expenses	\$ 32,231	Expenses not incurred for 5 authorized projects
3	Legal Expenses	\$ 3,576	Legal work not related to authorized projects
4	Slant well related costs	\$ 20,000	Project is not authorized for reimbursement through AL 932 Per D. 10-12-016
5	Invoices with missing description of work done	\$ 62,633	Unable to verify work done
6	AFUDC	\$ 3,382	Pro-rated AFUDC
7	<b>Ln 1 thru 5 Total w/o AFUDC</b>	<b>\$ 196,026</b>	
8	<b>Ln 6 + 7 Total including AFUDC</b>	<b>\$ 199,408</b>	

***(a) Unsubstantiated labor overhead***

Cal-Am claims \$77,586 for labor overheads. As described in Section II 2.i above, Cal-Am's support for these expenditures is based on witness testimony in A.11-06-030 that describes the components used in computing the labor overhead.

Cal-Am has not provided documentation supporting computations that show the derivation of the claimed labor overhead costs being requested here. As such, DWA is unable to verify these claims. DWA recommends that \$77,586 of unsubstantiated labor overhead costs should not be authorized in rates as part of AL 932. We concur.

If Cal-Am claims labor overhead costs in future rate base offset advice letter filings pursuant to D.10-12-016, it should provide documentation support computation of labor overhead costs. This will facilitate verification of labor overhead costs for prudence.

***(b) Improperly claimed outreach expenses***

Cal-Am requested \$149,340 for outreach related costs. Of the claimed amounts, only \$117,109 could be traced to outreach related with the five authorized projects. DWA recommends that the remaining \$32,231 that is not specifically related to the five authorized projects should not be authorized in rates as part of AL 932.

***(c) Improper legal expenses***

DWA recommends that \$3,576 for legal expenses not be authorized in rates as part of AL 932. These expenses were incurred for activities that are not related to the five authorized projects for which recovery by rate base offset advice letter was authorized in D.10-12-016.

***(d) Slant well related costs (\$20,000)***

DWA recommends that \$20,000 not be authorized in rates as part of AL 932 for costs associated with Slant Wells. Slant Wells are not one of the five projects authorized for recovery by rate base offset advice letters in D.10-12-016.

***(e) Invoices lacking description of work done***

DWA recommends that \$62,683 in expenditures with invoices that lack description of work done should not be authorized in rates as part of AL 932. The appropriateness of those amounts could not be verified.

***(f) Pro-rated AFUDC***

DWA recommends that \$3,382, the proportional amount for AFUDC based on the total amount not authorized should not be authorized in rates as part of AL 932.

Although Cal-Am claims that the above expenditures were incurred for the Regional Desalination Project, since the expenditures were either not for the five authorized Cal-Am only facilities or were inappropriately claimed, these costs are not recoverable through the rate base offset advice letter process authorized in D.10-12-016. Until allowed in rate base, all project related costs requested but not authorized for recovery in this resolution are entitled to earn AFUDC.<sup>14</sup> For the costs not authorized in rates in this resolution, Cal-Am can seek their recovery as directed by the Commission through a subsequent filing subject to prudence review pursuant to D.12-07-008, Ordering Paragraph No. 2.<sup>15</sup>

**IV. IMPLEMENTATION OF RATES PER AL 932**

D.10-12-016 permits Cal-Am to transfer to rate base and modify its associated revenue requirements for prudently expended costs, for Cal-Am only facilities, subject to true-up, if the Commission staff has not completed its prudence review of Cal-Am's filing within 45 days of that filing.<sup>16</sup>

Staff was unable to complete its "Prudence" review within 45 days of filing of AL 932. As permitted by the D.10-12-016, Cal-Am transferred to rate base, \$716,621 including \$12,163 for AFUDC. The corresponding revenue requirement is \$92,202. Cal-Am increased its rates accordingly effective January 1, 2012.

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<sup>14</sup> Section 13.2.2, Paragraph 2 of D.10-12-016 "..... Until allowed in rate base, all project costs are to earn AFUDC.....",

<sup>15</sup> D. 12-07-008, Ordering Paragraph 2 states:

".....[The recoverability of costs that have been incurred in Application (A.) 04-09-019 related to the Regional Desalination Project will be examined in other proceedings. Nothing herein is intended to prevent California-American Water Company from incurring reasonable costs related to its current application A.12-04-019...."

<sup>16</sup> D. 10-12-016, Section 13.2.4.2 states in relevant part:

".... As envisioned by the settling parties, Commission staff would have 45 days to review the advice letter for "prudence" and reg rates would go into effect, subject to true-up if the review could not be completed during that timeframe...."

" We agree with Cal-Am and the settling parties that it is reasonable to allow semi-annual advice letter filings and that a true-up is reasonable...."

Staff review indicates that of the amounts claimed in AL 932, \$517,212 was prudently expended by Cal-Am and \$199,408 of claims should not be authorized in rates at this time. The corresponding revenue requirement is \$65,435. Based on this, Cal-Am overcollected \$ 26,767 from ratepayers through December 31, 2012.<sup>17</sup> Due to this, it is reasonable to require Cal-Am to refund \$26,767, the excess amounts it has collected from ratepayers from January 1, 2012 through December 31, 2012, plus excess amounts collected from January 1, 2013 through the effective date of the Supplement to AL 932 through a sur-credit to all affected customers. Cal-Am should also adjust additions to its rate base to \$517,212, the prudently expended amounts and modify its tariffs accordingly.

It is reasonable to require Cal-Am to file a supplement to AL 932 adopting the rates shown in Appendix A. Additionally, within five days of the effective date of this Resolution, Cal-Am should file a Tier 1 AL implementing the refund of the excess amounts collected from ratepayers and modify the currently approved amounts to be added to rate base.

## **V. COMMENTS**

Public Utilities Code § 311(g) (1) generally requires that resolutions must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Accordingly, the draft resolution was mailed to Cal-Am, DRA, and one protestant for comments.

### ***Customer Comments and Disposition***

Comments were filed by six residents of the Hidden Hills community (customers) in Monterey. Cal-Am filed its response to the customer comments.

The customers stated that between 1963 and 1994, the Hidden Hills community was served by the Carmel Valley Mutual Water Company (CVMWCo). In 1994, CVMWCo was acquired by Cal-Am. Under terms of the purchase agreement, approved by the CPUC, Hidden Hills would be served by Cal-Am. Since Hidden Hills did not use any water from the Cal-Am's water system, Cal-Am would establish separate rates for Hidden Hills and would not pass on any costs associated with developing new water supplies for the Monterey Peninsula including the Seaside Basin and the Carmel River Resources area.

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<sup>17</sup> Revenue requirement based on AL 932 (\$92,202) less Revenue requirement based on allowed amount (\$65,435).

Pursuant to D.96-12-005, Ordering Paragraph # 7, the Commission authorized Cal-Am to consolidate its Hidden Hills subdivision into Monterey County District for ratemaking purposes only but not for delivery of water. Furthermore, The Regional Desalination Project (RDP) Settlement Agreement, which the Commission authorized in D.10-12-016, does not specifically exclude Hidden Hills from recovery of costs associated with Cal-Am only facility costs for the RDP. Therefore, it is appropriate to include Hidden Hills for recovery of costs associated with Cal-Am only facilities for the RDP.

***Cal-Am Comments and Disposition***

Cal-Am timely filed comments on the draft Resolution W-4940.

Cal-Am states that the Draft Resolution errs in affirming DWA's rejection of AL 923. Cal Am presents no new reasons to support its contention. Cal-Am's request to reverse the rejection of AL 923 should be rejected

Cal-Am requests that the Draft Resolution should be revised to grant recovery of the full \$716,620.51 claimed in AL 932 because: 1) the Draft Resolution's not authorizing amounts in rates is unreasonable, contrary to D.10-12-016, and inconsistent with Commission practice and procedure; 2) the Draft Resolution would require a level of supporting documentation that far exceeds the requirements of D.10-12-016; 3) not authorizing in rates \$114,065 in "Labor Overhead" costs appears to be based on a misinterpretation of the work papers submitted in support of AL 932; 4) not authorizing in rates \$20,000 for slant well related costs is unreasonable; and 5) not authorizing in rates the costs incurred for public outreach is unreasonable.

Based on a review of Cal-Am's work papers, the amount not authorized in rates for "Labor Overhead" has been modified from \$114,065 to \$77,586 for lack of appropriate documentation. The Draft Resolution has been modified accordingly. Cal-Am did not present any additional new arguments in its filed comments to justify modification of the other amounts not authorized in rates. We reviewed and previously considered every argument raised by Cal-Am in its comments as discussed herein and find no need to modify any other sections of Resolution W-4940 as drafted.

## **FINDINGS AND CONCLUSIONS:**

1. Commission Decision (D.)10-12-016, Ordering Paragraph (OP) Number 7, authorized five Cal-Am owned project facilities for the Regional Desalination Project (RDP).
2. D.10-12-016 permitted Cal-Am to file for recovery in rates amounts for the five Cal-Am owned project facilities for the Regional Desalination Project through semi-annual Tier 2 Advice Letter (AL) filings with the Commission.
3. Cal-Am filed AL 923 on November 23, 2011 to seek authority to implement a rate design change of \$785,460 including \$32,361 in Allowance for Funds Used During Construction (AFUDC) for expenditures the utility stated were associated with Commission authorized projects pursuant to D.10-12-016.
4. The Division of Ratepayer Advocates (DRA) protested AL 923 on December 21, 2011, and requested that Cal-Am's claim should be denied until the company provides the proper supporting documentation. Specifically, Cal-Am: (1) did not provide adequate support for certain capital expenditures; (2) did not cross-reference capitalized costs with authorized projects; (3) used an incorrect AFUDC rate; and (4) erred in increasing block 1 rates for the Bishop area.
5. Cal-Am argued that it provided adequate support to justify capital expenditures, no cross-referencing to authorized projects is required, and its AFUDC rate of 8.04% is appropriate.
6. Cal-Am corrected its tariff sheets to correct errors in its block 1 rates for the Bishop area.
7. The Division of Water and Audits (DWA) issued a Letter of Disposition on February 12, 2012, rejecting AL 923 without prejudice because of deficiencies in the submittal. Cal-Am could re-submit its AL after correcting the deficiencies. Deficiencies were: (1) no backup support for all labor and overhead expenses; (2) no cross-referencing of capital costs to authorized projects; and (3) not using the authorized AFUDC rate of 4.00%.
8. Cal-Am requested a formal review of DWA's Disposition of AL 923 on February 21, 2012. Cal-Am believes that DWA's rejection of AL 923 is unlawful, is erroneous and is unreasonable because Cal-Am (1) provided sufficient



documentation to explain its labor overhead expenses; (2) cross-referencing each expenditure to the authorized projects is not required by D.10-12-016; and (3) using an AFUDC rate of 4% is inconsistent with the directives contained in D.10-12-016 because its actual carrying costs for the project are 8.04%, its cost of capital.

9. Review of documentation provided to back-up on all labor overhead costs is essential to justify prudence of such costs.
10. DWA's request for backup documentation for labor and overhead expenses is reasonable.
11. Cross-referencing of costs to approved projects is necessary to ensure the prudence requirement of D.10-12-016.
12. DWA's request to map each cost to specific projects is a reasonable way of verifying prudence of each expense.
13. D.10-12-016 requires an initial interest rate of 4.00% subject to true-up to reflect the actual carrying costs for AFUDC.
14. Cal-Am used 8.04%, its authorized cost of capital for AFUDC.
15. Cal-Am did not sufficiently demonstrate that 8.04% was the best available rate for the project.
16. It is reasonable for Cal-Am to use an initial rate of 4.00% subject to true-up to reflect its actual carrying costs for AFUDC.
17. DWA's requirements for additional supporting documentation for labor related and overhead costs, cross-referencing costs to each authorized project, and using an initial AFUDC rate of 4.00% are reasonable.
18. Cal-Am filed AL 932 on February 27, 2012 replacing AL 923 to seek authority to implement a rate design change of \$716,621 including \$12,163 in AFUDC for expenditures associated with Commission authorized projects pursuant to D.10-12-016.

19. DRA protested AL 932 on March 15, 2012, arguing that Cal-Am's claims contained imprudently expended costs, and requested that any action on the AL 932 should be delayed pending a resolution of these issues.
20. DRA claims that Cal-Am's submittal lacked proper documentation to support certain capital expenditures.
21. DRA recommends that Cal-Am's claims should be denied pending a receipt of proper documentation to support its claims.
22. It is reasonable to require Cal-Am to provide documentation of all claimed amounts and to cross-reference each claimed amount with an authorized project.
23. DRA recommends that further action on AL 932 should be "stayed" because the Commission may modify D.10-12-016 because circumstances have changed since the decision was issued by the Commission.
24. The Commission has not issued an order to stay implementation of D.10-12-016.
25. DWA may not stay action on AL 932 without a Commission Order.
26. DRA claims that an initial AFUDC rate of 4.00 % is appropriate.
27. Cal-Am did not demonstrate that 8.04% is the best available rate for this project.
28. It is reasonable to use an initial 4% AFUDC rate for this project consistent with D.10-12-016.
29. DRA claims that Cal-Am erred in raising Block 1 rates for the Bishop area.
30. Cal-Am corrected the tariffs in AL 932 to reflect correct Block 1 rates for the Bishop area.
31. Cal-Am discovered an overestimation of general overhead costs of \$36,479.
32. Cal-Am reduced its claimed amounts in AL 932 by the erroneous claimed amounts.

33. Cal-Am's claims for \$517,212 including AFUDC of \$8,781 in AFUDC are appropriate for recovery through AL 932.
34. It is reasonable to permit Cal-Am to transfer \$517,212 including AFUDC of \$8,781 to rate base.
35. It is reasonable to permit Cal-Am to modify and file a Supplement to AL 932 to include revisions to Tariff Sheets for the Monterey District Tariff Area that reflect the transfer to rate base of the amount authorized in finding Number 34 above.
36. The DWA concluded that \$199,408 of Cal-Am's claimed expenses were unauthorized because they were either not specific to the five authorized projects or lacked proper justification. The unauthorized amounts are comprised of: (a) Unsubstantiated Labor overhead (\$77,586); (b) Improperly claimed outreach expenses (\$32,231); (c) Improper Legal expenses (\$3,576); (d) Slant Well related costs (\$20,000); (e) Invoices lacking description of work done (\$62,633) and (f) Prorated AFUDC for amounts not authorized in rates (\$3,382). These expenses should not be authorized in rates at this time.
37. Cal-Am should be permitted seek recovery of \$199,408, the amount not authorized in rates at this time, as directed by the Commission through a subsequent filing, subject to prudence review for reasonableness, pursuant to D.12-07-008, Ordering Paragraph No. 2.
38. Cal-Am transferred to rate base \$716,621, the amount sought in AL 932 on January 1, 2012. That amount is subject to "true-up" based on "prudence" review by Commission staff.
39. The correct amount to be transferred to rate base should be \$517,212.
40. It is reasonable for Cal-Am to correct the rate base addition to \$517,212.
41. Cal-Am collected \$92,202, its revenue requirement, from rate payers beginning January 1, 2012 through December 31, 2012.
42. Cal-Am's should have collected \$65,435 from rate payers through December 31, 2012.

43. It is reasonable for Cal-Am to refund \$26,767, the excess amounts collected from ratepayers from January 1, 2012 through December 31, 2012, plus excess amounts collected from January 1, 2013 through the effective date of the Supplement to AL 932 through a one-time sur-credit to all affected customers.
44. Cal-Am should file a Tier 1 AL showing the amounts refunded through a sur-credit, the excess amounts collected from ratepayers beginning January 1, 2012 through the effective date of the supplement to AL 932.

**THEREFORE IT IS ORDERED THAT:**

1. The Division of Water and Audits' letter of disposition rejecting California American Water Company's Advice Letter 923 is affirmed.
2. California American Water Company's request for amounts requested in Advice Letter 932 is hereby affirmed in part and rejected in part per Ordering Paragraphs 4 and 5 below.
3. California American Water Company may transfer to rate base \$517,212, which includes Allowance for Funds Used during Construction (AFUDC) of \$8,781.
4. California American Water Company's request for \$199,408, including \$3,382 for AFUDC, to be added to rate base is not authorized in rates at this time.
5. Within 5 days of the effective date of this Resolution, California American Water Company is authorized to file a Supplement to Advice Letter 932 incorporating the following Tariff Sheets shown in Attachment A for the Monterey District Tariff Area: 1) Schedule No. MO-1: General Metered Service (CPUC Sheet Nos. 6410-W through 6412-W Canceling CPUC Sheet Nos. 6247-W through 6249-W); and 2) Schedule MO-1-LIRA, Low-Income Ratepayer Assistance Program (CPUC Sheet Nos. 6413-W through 6414-W Canceling CPUC Sheet Nos. 6250 - W through 6251-W) to reflect the transfer to rate base of the amount authorized in Ordering Paragraph No. 3. New rates are to be effective 5 days after the filing of the Supplement to Advice Letter 932 subject to approval or rejection by the Division of Water and Audits consistent with this Resolution.

6. Within 5 days of the effective date of this Resolution, California American Water Company is ordered to file a Tier 1 Advice Letter implementing a one-time refund of the excess amount collected from customers pursuant to Advice Letter Number 932 from January 1, 2012 through the effective date of the Supplement to Advice Letter 932 in Ordering Paragraph No. 5 above.
7. This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on February 13, 2013; the following Commissioners voting favorably thereon:

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PAUL CLANON  
Executive Director

Attachment A – Sheet 1  
Schedule No. MO-1  
Monterey District Tariff Area  
GENERAL METERED SERVICE

APPLICABILITY

Applicable to all water furnished on a metered basis.

TERRITORY

The incorporated cities of Monterey, Pacific Grove, Carmel-by-the-Sea, Del Rey Oaks, Sand City, a portion of Seaside, Hidden Hills and Ryan Ranch subdivisions, Bishop subdivision including the area known as Laguna Seca Ranch Estates and vicinity and certain unincorporated areas in the County of Monterey.

RATES

Quantity Rates:

**MONTEREY MAIN SYSTEM**

	Base Rate	
	Per 10 cf	
<b>Residential &amp; Multi-Residential Customers:</b>		
For the first 10 cu. ft. x Customer Allotment .....	\$0.2826	
For the second 10 cu. ft. x Customer Allotment .....	\$0.3746	
For the third 10 cu. ft. x Customer Allotment .....	\$0.7491	
For the fourth 10 cu. ft. x Customer Allotment .....	\$1.4981	(I)
All Water over 40 cu. ft. x Customer Allotment .....	\$2.6217	
<b>Non-Residential Customers:</b>		
Block 1: For all water delivered up to monthly allotment .....	\$0.3746	
Block 2: For the next 15% of monthly allotment delivered .....	\$1.1236	
Block 3: For all water delivered over Block 2 .....	\$2.6217	
<b>Dedicated Irrigation:</b>		
Block 1: For all water delivered up to monthly allotment .....	\$0.7491	
Block 2: For all water delivered over monthly allotment .....	\$2.6217	
<b>Special Use Customers</b>		
For all water delivered .....	\$0.7491	(I)

Attachment A – Sheet 2  
Schedule No. MO-1 (Continued)  
Monterey District Tariff Area  
GENERAL METERED SERVICE

RATES (Continued):

Quantity Rates (Continued):

**HIDDEN HILLS AND RYAN RANCH SYSTEM**

	Base Rate Per 10 cf	
<b>Residential &amp; Multi-Residential Customers:</b>		
For the first 10 cu. ft. x Customer Allotment .....	\$0.2826	
For the second 10 cu. ft. x Customer Allotment .....	\$0.3746	(I)
For the third 10 cu. ft. x Customer Allotment .....	\$0.7491	
For the fourth 10 cu. ft. x Customer Allotment .....	\$1.1236	
All Water over 40 cu. ft. x Customer Allotment .....	\$1.8727	
<b>Non-Residential Customers:</b>		
Block 1: For all water delivered up to monthly allotment .....	\$0.3746	
Block 2: For the next 15% of monthly allotment delivered .....	\$1.1236	
Block 3: For all water delivered over Block 2 .....	\$2.6217	
<b>Dedicated Irrigation:</b>		
Block 1: For all water delivered up to monthly allotment .....	\$0.7491	
Block 2: For all water delivered over monthly allotment .....	\$2.6217	
<b>Special Use Customers</b>		
For all water delivered .....	\$0.7491	(I)

(Continued)

Attachment A – Sheet 3  
Schedule No. MO-1 (Continued)  
Monterey District Tariff Area  
GENERAL METERED SERVICE

RATES (Continued):

Quantity Rates (Continued):

**BISHOP SYSTEM**

	Base Rate Per 10 cf	
<b>Residential &amp; Multi-Residential Customers:</b>		
For the first 10 cu. ft. x Customer Allotment .....	\$0.1869	
For the second 10 cu. ft. x Customer Allotment .....	\$0.2811	(I)
For the third 10 cu. ft. x Customer Allotment .....	\$0.4684	
For the fourth 10 cu. ft. x Customer Allotment .....	\$0.6557	
All Water over 40 cu. ft. x Customer Allotment .....	\$0.7498	
<b>Non-Residential Customers:</b>		
Block 1: For all water delivered up to monthly allotment .....	\$0.3746	
Block 2: For the next 15% of monthly allotment delivered .....	\$1.1236	
Block 3: For all water delivered over Block 2 .....	\$2.6217	
<b>Dedicated Irrigation:</b>		
Block 1: For all water delivered up to monthly allotment .....	\$0.7491	
Block 2: For all water delivered over monthly allotment .....	\$2.6217	
<b>Special Use Customers</b>		
For all water delivered .....	\$0.7491	(I)

Meter Rates:

**MONTEREY MAIN, HIDDEN HILLS, RYAN RANCH, AND BISHOP SYSTEMS**

	Per Meter Per Month
For 5/8 x 3/4-inch meter .....	\$8.91
For 3/4-inch meter .....	\$13.37
For 1-inch meter .....	\$22.28
For 1-1/2-inch meter .....	\$44.55
For 2-inch meter .....	\$71.28
For 3-inch meter .....	\$133.65
For 4-inch meter .....	\$222.75
For 6-inch meter .....	\$445.50
For 8-inch meter .....	\$712.80



Attachment A – Sheet 4  
Schedule No. MO-1-LIRA  
Monterey District Tariff Area  
LOW-INCOME RATEPAYER ASSISTANCE PROGRAM (LIRA)

APPLICABILITY

Applicable to all water furnished on a metered basis.

TERRITORY

The incorporated cities of Monterey, Pacific Grove, Carmel-by-the-Sea, Del Rey Oaks, Sand City, a portion of Seaside, Hidden Hills and Ryan Ranch subdivisions, Bishop subdivision including the area known as Laguna Seca Ranch Estates and vicinity and certain unincorporated areas in the County of Monterey.

RATES

Quantity Rates:

**MONTEREY MAIN SYSTEM**

	Base Rate Per 10 cf	
<b>Residential &amp; Multi-Residential Customers:</b>		
For the first 10 cu. ft. x Customer Allotment .....	\$0.2826	(I)
For the second 10 cu. ft. x Customer Allotment .....	\$0.3746	
For the third 10 cu. ft. x Customer Allotment .....	\$0.7491	
For the fourth 10 cu. ft. x Customer Allotment .....	\$1.4981	
All Water over 40 cu. ft. x Customer Allotment .....	\$2.6217	

**HIDDEN HILLS AND RYAN RANCH SYSTEM**

	Base Rate Per 10 cf	
<b>Residential &amp; Multi-Residential Customers:</b>		
For the first 10 cu. ft. x Customer Allotment .....	\$0.2826	(I)
For the second 10 cu. ft. x Customer Allotment .....	\$0.3746	
For the third 10 cu. ft. x Customer Allotment .....	\$0.7491	
For the fourth 10 cu. ft. x Customer Allotment .....	\$1.1236	
All Water over 40 cu. ft. x Customer Allotment .....	\$1.8727	

(Continued)

Attachment A - Sheet 5  
Schedule No. MO-1-LIRA (Continued)  
Monterey District Tariff Area  
LOW-INCOME RATEPAYER ASSISTANCE PROGRAM (LIRA)

RATES (Continued):

Quantity Rates (Continued):

**BISHOP SYSTEM**

	Base Rate <u>Per 10 cf</u>	
<b>Residential &amp; Multi-Residential Customers:</b>		
For the first 10 cu. ft. x Customer Allotment .....	\$0.1869	
For the second 10 cu. ft. x Customer Allotment .....	\$0.2811	(I)
For the third 10 cu. ft. x Customer Allotment .....	\$0.4684	
For the fourth 10 cu. ft. x Customer Allotment .....	\$0.6557	
All Water over 40 cu. ft. x Customer Allotment .....	\$0.7498	(I)

Meter Rates:

**MONTEREY MAIN, HIDDEN HILLS, RYAN RANCH, AND BISHOP SYSTEMS**

	<u>Per Month</u>
For 5/8 x 3/4-inch meter .....	\$8.91
For 3/4-inch meter .....	\$13.37
For 1-inch meter .....	\$22.28
For 1-1/2-inch meter .....	\$44.55
For 2-inch meter .....	\$71.28
For 3-inch meter .....	\$133.65
For 4-inch meter .....	\$222.75
For 6-inch meter .....	\$445.50
For 8-inch meter .....	\$712.80